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From Mining to Refining: Low Commodity Prices Force Shift at Industry Giants

Share prices of many mining companies have fallen sharply this year

The mining site of Vale, the biggest Brazilian mining company, in Para state, Brazil. *PHOTO: YASUYOSHI CHIBA/AGENCE FRANCE-PRESSE/GETTY IMAGES*

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The world's largest mining companies have plenty of nickel. Now they are scrounging around for nickels.

In a sign of desperation amid plunging commodity prices, mining companies are delving into low-margin businesses—traditionally the domain of the industry's middlemen—for new sources of revenue.

Rio Tinto PLC for the first time has started to refine other companies' copper ore. Brazil's Vale SA, the world's largest iron-ore producer, has begun mixing minerals to make custom supplies for buyers. U.S. coal miner Murray Energy Corp. started its own trading unit in June.

The mining companies are seeking to alleviate the financial pressure caused by tumbling raw-materials prices. With industrial metals and coal at lows last seen during the financial crisis, the share prices of many companies have collapsed by more than half in the past year. A global supply glut and weak demand have spurred the selloff in futures markets and mining stocks.

Anglo American PLC alone posted a $6 billion loss for the year ended June 30, compared with a $100 million profit in the previous period.

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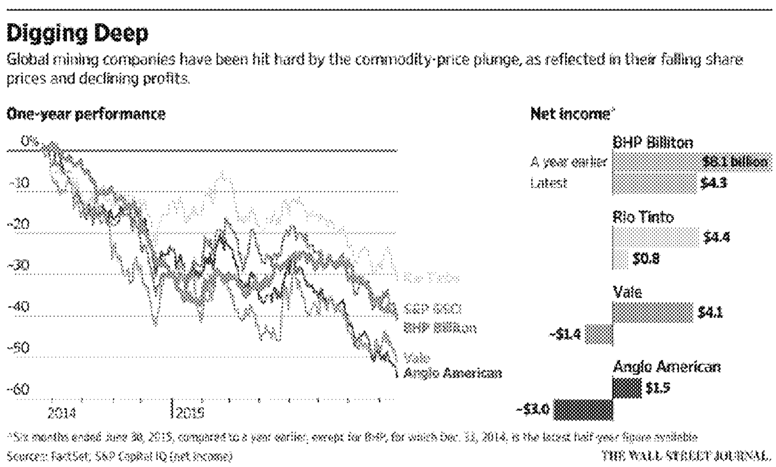
"Everybody is trying to find ways to squeeze out whatever they can," said Rick de los Reyes, who helps manage $1.5 billion invested in metals and mining at T. Rowe Price. "Everybody is fighting to stay alive."

The scramble for revenue, no matter how small, is an example of how producers are grappling with the commodities bust following an extended boom fueled by China's rapid growth. It is also a tacit acknowledgment that raw-materials prices are likely to remain low for an extended period, a challenge for companies that borrowed heavily to scoop up mines when prices were high.

Iron ore has slid 22% this year, and copper is down 18%. Nickel has tumbled 31%, while coal has fallen at least 10%, depending on the type.

In the first quarter, trucks laden with tons of bluish-gray rocks that contain copper started to rumble across Utah to Rio Tinto's smelting facility, with a smokestack nearly as tall as the Empire State Building, on the southern shore of the state's Great Salt Lake. But in a shift from the past, the copper ore is owned by other producers, which are paying Rio Tinto a fee to heat the rocks to 2,400 degrees Fahrenheit to pry the copper loose of silica, iron and sulfur.



"It is vital that we remain focused on reducing our costs, increasing our productivity and ensuring that we derive the maximum value from our operations," said Jean Sébastien Jacques, chief executive of Rio Tinto's copper and coal group.

For years, mining companies left refining, blending and trading of ores to multinational commodity traders such as Glencore PLC and Trafigura Beheer BV. Now, miners are encroaching on trading firms' turf. Glencore and Trafigura declined to comment.

The strategy is fraught with risks, and the profit potential is scant, some analysts and investors said. These downstream activities are capital-intensive, margins are razor-thin and ill-timed trades could result in steep losses, they said.

"It is probably not the best odds that it will work out real well or they would have been in that business in the first place," said Michael Ball, portfolio manager with Weatherstone Capital Management, which oversees $675 million. The efforts "speak to the fact that companies believe they've got a longer-term issue on their hands."

Weatherstone closed out its sole mining-sector bet nine months ago and is avoiding new wagers due to signs of slack metal demand in a sluggish global economy.

Lucas Pipes, a metals and mining-sector analyst at investment bank FBR & Co., said it is prudent for mining companies to expand the range of their operations, but the returns on these activities for most won't be much more than a rounding error.

"This is common for the bottom: You're fighting over pennies," Mr. Pipes said.

Last fall, Vale opened a $1.4 billion ore-blending terminal in Malaysia, to better cater to Asian buyers. Vale's customers have been willing to pay extra for that blended ore, as much as $3 a ton on top of the benchmark price, most recently $55.90 a metric ton, company executives have said.

Anglo American's decision to trade its own platinum-group metals, such as palladium and rhodium in addition to platinum, has bolstered profit at Anglo American Platinum by 2%, said Andrew Hinkly, executive head of marketing at the subsidiary.

Anglo American ended its two-decade arrangement to sell these metals through Johnson Matthey PLC, a specialty-chemicals company, in 2012.

"Does it move the needle? No it doesn't," said Tim Gramatovich, chief investment officer at Peritus Asset Management, which oversees about $1 billion. It "provides some stability to what they're doing…but the only thing that brings these guys back is supply and demand."

Some mining companies said few choices are left. In the U.S., several coal-mining firms have recently filed for bankruptcy protection, and healthier rivals are exploring trading as a way to keep coal competitive with a flood of natural gas.

Murray Energy Corp., based in St. Clairsville, Ohio, started its own trading unit, Javelin Global Commodities, to pioneer contracts with flexible pricing and volumes. It is a departure for an old-fashioned company whose chief executive refers to his supply contracts as "marriages." Last week, Murray also bought its first mines outside the U.S. from Goldman Sachs Group Inc. with an eye to blending Colombian coal with U.S. coal for international buyers.

"The producers can't just sit on their hands and say they can't do deals like that," said Peter Bradley, Javelin's chief executive and a former commodities trader at Goldman Sachs. "Otherwise, their industry is going to go away."

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